ALTERNATIVE FORECASTS

DRI has assigned a 55% probability of occurrence to its September 2000 baseline forecast of the U.S. economy. The major features of this forecast include:

- Real GDP expands by a healthy 5.2% in 2000, 3.6% in 2001, 4.2% in 2002, and 4.7% in 2003;
- U.S. nonfarm employment grows 2.1% this year, 1.0% next year, 1.2% in 2002, and 1.8% in 2003;
- the U.S. civilian unemployment rate remains below the full employment rate of 5.5%;
- consumer confidence slowly tapers off over the forecast period, but remains over 100;
- after hitting 3.3% this year, inflation drops below 2.5% in the remaining years of the forecast;
- the federal budget surplus swells to nearly $260 billion in 2003;
- and the U.S. merchandise trade deficit widens.

While the baseline scenario represents the most likely path for the national economy over the next few years, uncertainties surrounding several key variables mean other outcomes are also possible. To account for this, DRI prepares alternative forecasts based on different assumptions regarding these key variables. Two of these alternative forecasts, along with their likely impacts on the Idaho economy, are discussed below.

While it is believed the U.S. economy will not suffer a recession over the forecast period, it should be noted the risk of a recession is high. A review of the probabilities of occurrence for each forecast scenario shows this. The baseline does not include a recession and the probability of occurrence is 55%. However, both of the alternative scenarios do contain recessions and their combined probability of occurrence is 45%. This implies the chances of the economy not suffering a recession over the next few years, barely better than even.

PESSIMISTIC SCENARIO

The *Pessimistic Scenario* has been assigned a 15% probability of occurrence. In this scenario the current expansion ends in its traditional fashion. Every postwar expansion has ended with rising inflation leading to an overreaction by the Federal Reserve. The higher interest rates, with an assist from an external or fiscal shock, causes a recession. The tight labor market is the main reason to fear higher inflation. Indeed, wages have recently been pushed up by the scarcity of labor. If the unemployment rate drops further, labor costs could accelerate. In addition, the recent resurgence of health care costs could worsen, exacerbating employment-cost inflation. Rising energy prices are also fueling inflation jitters. But rising oil prices will not only impact inflation, they will also widen the nation’s trade deficit which will pour another ladle of ice water on the already cooling stock market.

In this scenario, consumer inflation hits 4% in late 2001. In response, the Federal Reserve raises the federal funds rate to 8.0% by early 2002. The stock market corrects sharply. Facing disappearing wealth and higher borrowing costs, American consumers retrench. This sets in motion a domino effect that culminates with the economy falling into a short recession in early 2002. The Federal Reserve responds quickly, limiting the peak-to-trough drop in real GDP to less than 1.0%. The slowdown causes the unemployment rate to peak at 6.3% in mid-2003. The lower interest rates help the economy recover quickly. The lack of significant internal imbalances also helps keep the recession tame. This, too, is a traditional feature of recessions. In general, long expansions are followed by mild, not severe, recessions. This scenario’s recession fits that mold.

IDAHO ECONOMIC FORECAST
BASELINE AND ALTERNATIVE FORECASTS
OCTOBER 2000

	BASELINE				PESSIMISTIC				LATE RECESSION			
	2000	**2001**	**2002**	**2003**	**2000**	**2001**	**2002**	**2003**	**2000**	**2001**	**2002**	**2003**
GDP (BILLIONS)												
Current $	10,002	10,599	11,237	11,979	10,016	10,747	11,371	11,910	10,001	10,632	11,370	12,132
% Ch	*7.6%*	*6.0%*	*6.0%*	*6.6%*	*7.7%*	*7.3%*	*5.8%*	*4.7%*	*7.6%*	*6.3%*	*6.9%*	*6.7%*
1996 Chain-Weighted	9,337	9,671	10,078	10,551	9,346	9,720	9,899	10,098	9,338	9,702	10,173	10,618
% Ch	*5.2%*	*3.6%*	*4.2%*	*4.7%*	*5.3%*	*4.0%*	*1.8%*	*2.0%*	*5.2%*	*3.9%*	*4.9%*	*4.4%*
PERSONAL INCOME - CURR $												
Idaho (Millions)	31,371	33,568	35,649	37,895	31,412	33,899	36,325	38,243	31,371	33,561	35,769	38,161
% Ch	*6.8%*	*7.0%*	*6.2%*	*6.3%*	*6.9%*	*7.9%*	*7.2%*	*5.3%*	*6.8%*	*7.0%*	*6.6%*	*6.7%*
U.S. (Billions)	8,287	8,791	9,283	9,850	8,296	8,881	9,433	9,808	8,287	8,800	9,362	10,000
% Ch	*6.4%*	*6.1%*	*5.6%*	*6.1%*	*6.5%*	*7.0%*	*6.2%*	*4.0%*	*6.4%*	*6.2%*	*6.4%*	*6.8%*
PERSONAL INCOME - 1996 $												
Idaho (Millions)	29,175	30,617	31,995	33,401	29,193	30,565	31,550	32,430	29,174	30,527	31,896	33,143
% Ch	*4.1%*	*4.9%*	*4.5%*	*4.4%*	*4.2%*	*4.7%*	*3.2%*	*2.8%*	*4.1%*	*4.6%*	*4.5%*	*3.9%*
U.S. (Billions)	7,708	8,019	8,332	8,682	7,711	8,008	8,194	8,318	7,708	8,005	8,349	8,686
% Ch	*3.7%*	*4.0%*	*3.9%*	*4.2%*	*3.8%*	*3.9%*	*2.3%*	*1.5%*	*3.7%*	*3.9%*	*4.3%*	*4.0%*
TOTAL NONFARM EMPLOYMENT												
Idaho (Thousands)	557.3	572.3	586.1	600.4	557.5	572.8	583.4	589.8	557.3	572.1	585.8	599.0
% Ch	*3.4%*	*2.7%*	*2.4%*	*2.4%*	*3.4%*	*2.8%*	*1.8%*	*1.1%*	*3.4%*	*2.7%*	*2.4%*	*2.2%*
U.S. (Millions)	131.4	132.7	134.3	136.7	131.5	133.2	133.5	132.6	131.4	132.9	135.1	137.6
% Ch	*2.1%*	*1.0%*	*1.2%*	*1.8%*	*2.1%*	*1.3%*	*0.2%*	*-0.7%*	*2.1%*	*1.1%*	*1.6%*	*1.9%*
GOODS PRODUCING SECTOR												
Idaho (Thousands)	116.6	118.7	120.2	122.9	116.7	119.3	120.6	121.1	116.6	119.0	121.2	123.6
% Ch	*2.7%*	*1.8%*	*1.3%*	*2.2%*	*2.8%*	*2.2%*	*1.1%*	*0.4%*	*2.7%*	*2.0%*	*1.8%*	*2.0%*
U.S. (Millions)	25.7	25.3	24.8	24.7	25.7	25.5	24.7	23.5	25.7	25.4	25.0	24.8
% Ch	*0.7%*	*-1.5%*	*-1.8%*	*-0.6%*	*0.8%*	*-0.8%*	*-3.2%*	*-4.6%*	*0.7%*	*-1.2%*	*-1.3%*	*-0.8%*
SERVICE PRODUCING SECTOR												
Idaho (Thousands)	440.7	453.7	465.8	477.5	440.8	453.5	462.8	468.7	440.7	453.1	464.7	475.4
% Ch	*3.6%*	*2.9%*	*2.7%*	*2.5%*	*3.6%*	*2.9%*	*2.0%*	*1.3%*	*3.6%*	*2.8%*	*2.5%*	*2.2%*
U.S. (Millions)	105.8	107.4	109.5	112.0	105.8	107.7	108.8	109.1	105.8	107.6	110.1	112.8
% Ch	*2.4%*	*1.6%*	*1.9%*	*2.3%*	*2.4%*	*1.8%*	*1.0%*	*0.2%*	*2.4%*	*1.7%*	*2.3%*	*2.5%*
SELECTED INTEREST RATES												
Federal Funds	*6.2%*	*6.4%*	*6.1%*	*6.0%*	*6.3%*	*7.2%*	*7.1%*	*4.9%*	*6.2%*	*5.9%*	*5.8%*	*7.3%*
Bank Prime	*9.2%*	*9.4%*	*8.9%*	*8.3%*	*9.3%*	*10.2%*	*10.1%*	*7.9%*	*9.2%*	*8.9%*	*8.8%*	*10.3%*
Existing Home Mortgage	*8.0%*	*7.5%*	*7.1%*	*6.9%*	*8.0%*	*8.0%*	*8.4%*	*6.8%*	*8.0%*	*7.2%*	*6.9%*	*7.8%*
INFLATION												
GDP Price Deflator	*2.3%*	*2.3%*	*1.7%*	*1.8%*	*2.3%*	*3.1%*	*3.9%*	*2.7%*	*2.3%*	*2.3%*	*2.0%*	*2.2%*
Personal Cons Deflator	*2.5%*	*2.0%*	*1.6%*	*1.8%*	*2.6%*	*3.1%*	*3.8%*	*2.4%*	*2.5%*	*2.2%*	*2.0%*	*2.7%*
Consumer Price Index	*3.3%*	*2.2%*	*1.7%*	*1.9%*	*3.3%*	*3.1%*	*3.6%*	*2.5%*	*3.3%*	*2.5%*	*2.0%*	*2.7%*

Forecast Begins the SECOND Quarter of 2000

Idaho's economy follows a similar path as its national counterpart. That is, marginally faster growth in the first two years of the forecast is followed by significantly weaker growth in 2002 and 2003. Idaho nonfarm employment is forecast to advance 3.4% in 2000 and 2.7% in 2001 in the baseline. In this scenario it grows 3.4% this year and 2.8% next year. It then slows to 1.8% in 2002 and 1.1% in 2003. In comparison, baseline nonfarm employment grows by 2.4% in both of these years. Idaho real personal income growth trails off from the baseline more noticeably due to the higher inflation in this scenario compared to the baseline.

LATE RECESSION SCENARIO

The *Late-Recession Scenario* has been assigned a 30% probability of occurrence. The more likely of the two alternative scenarios considered here, it also contains the more severe downturn because imbalances are allowed to build longer. This scenario assumes that European and Asian economic growth outrun expectations causing funds to shift to other markets, which in turn pushes the dollar lower. Subsequently, this raises the cost of imported goods and boosts exports, both of which put upward pressure on prices. In addition, the tight labor market pushes employer costs upwards. In an attempt to keep inflation from getting out of control, the Federal Reserve begins to tighten. Unfortunately, it is not aggressive enough to completely tame inflation.

Rising interest rates help strengthen the dollar. However, they hammer the stock market and consumer confidence. With the leading edge of the baby boom approaching retirement age, there is a rush to shift assets out of stocks and into fixed-income securities—further worsening the stock market slide. The slide in U.S. growth lowers the prospects for foreign growth, thereby adding upward pressure on the dollar. The resulting slowdown in exports and pickup in imports aggravate the negative impact of higher interest rates and the drop in equity prices. The economy turns down in 2004,with real GDP dropping 1.0% over the course of three quarters.

Idaho's economic performance in this scenario is very similar to that of the baseline. This is because the national recession does not occur until 2004, which is outside the range of this forecast horizon. Idaho nonfarm employment is 599,000 in 2003, just 1,400 lower than in the baseline. Likewise, Idaho real personal income is $33.1 billion in 2003, which is about $250 million lower than in the baseline. However, it is much closer than the real personal income in the *Pessimistic Scenario*. In that case, Idaho real personal income is about a billion dollars lower in 2003 compared to the baseline figure.